TEACHERS'
PENSION PLAN

PENSION WISE

A NEWSLETTER FOR ONTARIO TEACHERS

SUMMER 2012

Dispelling funding myths

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INSIDE THIS ISSUE

MYTH OR FACT:
CAN YOU SPOT THE DIFFERENCE?

Pensionwise explores common misconceptions to help you separate funding facts from funding fiction.

1

Myth: The Teachers' pension plan won't be around when I retire.

Fact: The pension plan is sustainable — it just may look different in the future than it does now. The Ontario Teachers' Federation and the Ontario government are committed to adapting the pension plan so it remains viable and affordable for all generations of teachers.

2

Myth: The Teachers' pension plan is in financial crisis.

Fact: The pension plan has $117.1 billion in assets, enough to pay pensions for many years. But shortfalls are projected to arise when we look ahead 70 years or more, when today's youngest teachers will still be collecting their pensions.

At least once every three years, the pension plan must show that it will have sufficient assets to meet its long-term pension obligations to all current members. If there's a projected shortfall, it must be eliminated.

3

Myth: If the pension plan made more money, we wouldn't have a funding problem.

Fact: The Teachers' pension plan has experienced recurring funding shortfalls because liabilities (the cost of future pensions) are growing faster than plan assets, despite strong investment performance.

Last year, the pension plan earned an 11.2% rate of return on its investments. A study of pension funds around the world showed the Teachers' plan had the highest 10-year total investment return to the end of 2010. The study was conducted by CEM Benchmarking Inc., a leading authority on pension fund performance.

Want More?

You can find more myths vs. facts at
FundingYourPension.com

Why do we have another projected shortfall?

Most members know that increased life expectancy is one of the factors driving up pension costs. While demographics such as this weigh heavily on the plan's funding status, there are three primary drivers to the 2012 preliminary shortfall. These include, in addition to demographics, historically low interest rates and the absorption of investment losses from 2008.

When interest rates drop, the plan needs to set more money aside to pay future pensions. Interest rates are at the lowest levels since the 1950s and 1960s. To put this into context, it costs 50% more to secure a typical pension today than it did in 1990.

Assets required for a typical $40,000 pension

Real Interest Rate	Amount Required
1.0%	$970,000
1.5%	$900,000
2.0%	$835,000
3.0%	$730,000
4.0%	$645,000
5.0%	$575,000

The plan's investment loss during the height of the financial crisis in 2008 is being smoothed over five years. Smoothing is an accepted practice that allows plan managers to spread gains or losses on investments over a few years. By doing so, they are able to avoid having to make frequent adjustments to benefits or contribution rates.

In 2011, Teachers' absorbed $5.2 billion of the 2008 loss, and will absorb another $5.2 billion in 2012. However, these losses are being largely offset by investment gains over the last few years. For example, despite tough markets, the Teachers' pension plan generated $11.7 billion in investment income in 2011.

"Economic, investment and demographic conditions have changed radically since 1990. We are faced largely with a systemic problem, and not a one-time anomaly. We've had recurring shortfalls for several years," says Jim Leech, Teachers' President and CEO.

"We are committed to working with the Ontario Teachers' Federation and the Ontario government for fair and equitable solutions — to be introduced over time; well-researched, well-informed decisions in our members' best interests. We are all living longer and that is great — we just need to adjust to our new reality. A course correction now will have a major impact tomorrow," says Jim.

"This plan will evolve — all plans have to evolve given the environment. It may look slightly different in the future but the pensions will be there for the teachers of Ontario."

Key Figures

Net assets as of Jan. 1, 2012:

$117.1 billion

The pension plan has

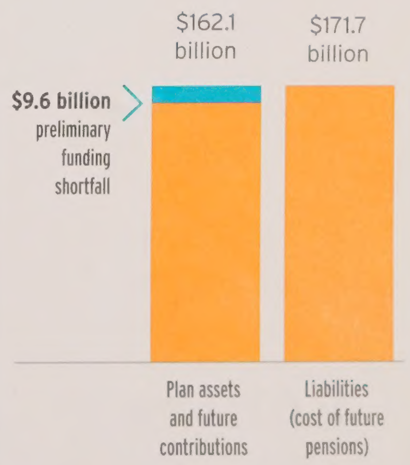
94%

of the estimated funds required to meet its future pension obligations.

Preliminary shortfall as of Jan. 1, 2012:

$9.6 billion

2012 Preliminary Funding Valuation



TEACHERS' NAVIGATES CHOPPY WATERS TO DELIVER STRONG RETURNS

Teachers' 2011 investment performance highlights

Rate-of-return:
11.2%

Benchmark rate-of-return:
9.8%

Value-added return:
$1.4 billion

Investment income:
$11.7 billion

Teachers' saw another year of investment results surpassing benchmark returns, taking net assets to an all-time high. The Investment Division navigated chaotic markets and dealt with sluggish economies while managing risk to produce strong returns for the third straight year.

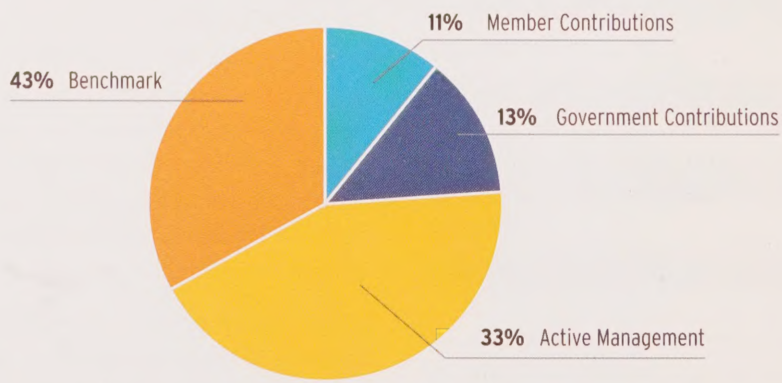
What role do investment strategies play in paying your pension?

Because pension benefits paid to retirees exceed member and government contributions by nearly $2 billion annually, investment activity fuels the plan. The plan actively works to create value-added returns by exceeding benchmark returns that could be achieved from a more passive investment approach.

"The $1.4 billion in value-added in 2011 was enough to pay 37,000 average pensions for an entire year," says Neil Petroff, Executive Vice-President, Investments.

And since the fund's creation in 1990, value-added returns have increased the plan's assets by $53 billion. Value-added returns represent 33% of the plan's total income for the same period, and benchmark returns represent 43%. These exceed the combined contributions from members and the government that accounted for 24% of the total.

Income sources since fund's creation in 1990



Government contributions are 2% more than member contributions because of special contributions the government made to pay down the plan's pre-1990 unfunded liability.

What effect do a tsunami in Japan, uprisings in the Middle East and riots in Athens have on your pension?

Last year proved to be the costliest in history, according to the United Nations. Earthquakes in Japan and New Zealand, a Japanese tsunami, Thai floods, political upheaval and unrest in the Middle East, and history's largest sovereign default in Greece drove global economic losses to as much as $380 billion.

"The global economy is more interconnected today than any other time in history," says Neil. "For example, the economic aftershocks of Japan's tsunami were felt in auto plants in Canada."

Ongoing economic uncertainty and continuing low interest rates mean the plan must project more modest investment returns. For example, the 10-year current outlook for the gross domestic product is 2.05%, compared to 3.1% at the plan's creation, making it harder to drive large returns. Additionally, interest rates are at the lowest level since the 1950s and 1960s, so plan managers need to set aside more money to pay pensions. In 2011, real return bond yields were 0.45% versus 4.5% in 1990.

"We know that there are systemic issues which we cannot control; however, the investment team is working very hard on the things we can control to optimize their portfolios," says Neil. "We have the right investment management team with our 'secret sauce' of collaboration, innovation, good judgment and courage to help us navigate through uncertain times."

How does a 108-year-old retired teacher influence investment strategy?

A sluggish economy with sagging interest rates presents a challenge, but investment managers are hampered even further by the maturity of the plan.

The Teachers' pension plan is maturing. In addition to benefits exceeding contributions, retired teachers are living much longer than in the past and the ratio of working members to retired members is declining. Last year, the plan had 102 retired members over 100 years of age. With the typical teacher working for 26 years, this means members are increasingly spending more years on pension than contributing to the plan. And, in 1970, there were 10 working members to every retired member. By 2011, that ratio had decreased to 1.5 to 1.

These factors directly affect the plan's investment approach. With a maturing plan, investment managers need to be as concerned about the potential loss that may stem from an investment as they are about how much money can be made from the investment.

"Our risk appetite has declined," says Rosemarie McClean, Senior Vice-President, Member Services. "We have fewer active members now to bear the burden of a negative market event through contribution increases."

While equities have historically provided higher returns, they also have a higher potential to decrease. In 1996, equities comprised 76% of Teachers' asset mix. Today, as a result of our lower risk appetite, they comprise less than half of the asset mix at 44%.

"Just when we need higher returns the most, our risk tolerance has been lowered by demographic realities so we can't afford to take more risk to close the funding gap," says Neil Petroff, Executive Vice-President, Investments.

Ratio of working-to-retired memebers

Increase in contribution rate for a 10% decline in assets

LEADING THE WAY

Teachers' earned top ranks in both investment and service categories of international benchmark studies.

Competition really heats up this time of year. Baseball season is well underway and in a few months the 2012 Summer Olympics will kick-off in London.

At Teachers', we thrive on the challenge of trying to be the best.

"Teachers' has demonstrated industry leadership on both the investment side and on the member service side," says Tom Scheibelhut, Managing Partner for CEM Benchmarking Inc., an independent authority on pension fund benchmarking.

We ranked first among our North American peers in two investment categories. The plan's 10-year total returns are the highest among global peer funds studied by CEM. And we were also number one in value added for the period.

In addition, we topped the list for exceptional pension service — the second time we've placed first in our group.

Remaining the best

There's nothing like healthy competition to keep you motivated. Once you're at the top, staying there can sometimes be more challenging than getting there.

"Teachers' has led the way in terms of thinking about assets and liabilities and because of that, they are way ahead of a lot of pension funds around the world," adds Tom.

When it comes to service, we try to improve every year and track member satisfaction through regular surveys conducted by a third party. This feedback forms our Quality Service Index (QSI), which measured 9 out of 10 in 2011. In fact, more than half of members gave us a perfect score of 10 out of 10.

We have maintained high QSI scores for several years, even though plan complexity from new regulations and compliance — and hence our workload —has increased. Ten years ago, there were 237,000 plan members; today there are 300,000. We completed 395,000 client interactions in 2011, a 4% increase over the prior year.

Balancing service and cost

We believe our members deserve timely, reliable service and pension information that is relevant to them at different stages of their careers.

Providing accurate and timely service in a complex pension plan is an accomplishment in itself, but we also continue to focus on offering exceptional service at a reasonable cost.

"We must balance service with costs, membership growth with web and system optimizations, and strategy with regulation," says Rosemarie McClean, Senior Vice-President, Member Services. "The CEM results help us validate the direction we are taking and identify areas where we can improve."

Who is CEM?

We measure our services against those of leading pension plans worldwide by participating in surveys conducted by CEM Benchmarking Inc., an independent research firm. Each year, CEM conducts independent evaluations of major pension plans around the world. This evaluation helps us better understand whether we are striking the right balance between services and costs.

Want More?

See Rosemarie McClean, Senior Vice-President, discuss what's behind Teachers' outstanding service at otpp.com/PensionNewsOnline.

YOU ASKED US...

Q. Is it likely that the 85 factor will be increased to deal with the funding shortfall?

A. We cannot speculate on how the Ontario Teachers' Federation (OTF) and the Ontario government will resolve the latest funding shortfall. At this point, no decisions have been made about any changes to the pension plan.

OTF and the government jointly sponsor the pension plan, and they make decisions on pension benefits and contribution rates. Our job is to provide the information they need to make informed decisions.

Q. If I have already reached my 85 factor, and the factor changes, will I still be able to retire with an unreduced pension?

A. Yes, under current Ontario law, pension benefits already earned cannot be reduced retroactively. This means you would continue to qualify to retire with an unreduced pension based on the credit you had earned up to the date of any change. However, any credit you earn after the date of any change would be based on the new provisions.

Q. When will I know what's going to change?

A. OTF and the government will decide how to resolve the shortfall this year, next year or any time before October 2014. Members will be notified as soon as decisions are reached. Keep in mind that several months' notice is usually given before any change goes into effect.

Q. Why does Teachers' use such a low rate of return assumption? Doesn't doing so overstate a funding shortfall?

A. The rate of return assumption, also called the discount rate, plays a critical role in projecting whether or not the pension plan will have enough assets to meet its future pension obligations. A lower rate of return assumption increases the projected cost of pensions; a higher rate lowers this cost.

When determining the assumption, the board uses as a guide post a three-year average of the yield on Government of Canada 30-year real-return bonds, plus a premium. The premium is either 0.5% (when the plan is in a strong financial position) or 1.4% (when the plan has a shortfall).

Last year, the rate of return assumption was validated by an independent hearing officer following an extensive review. The review was initiated by OTF and the government because of concerns that the rate might be too low, thus overstating the size of the shortfall in 2011. A similar review is underway this year.

Some other pension plans may use a higher rate of return assumption, but those plans tend to be far less mature than Teachers' and have members with shorter life expectancies.

Q. What impact will the proposed Ontario budget have on my pension?

A. It's not our place to comment on the government proposals, but we can tell you that the *Pension Benefits Act* protects the value of pension benefits already earned by working and retired members. Under this legislation, pension benefits cannot be reduced retroactively.

The plan's co-sponsors, the OTF and Ontario government, make decisions on pension benefits and contribution rates, with Teachers' providing advice and information.

Read more Top Plan Funding Q&As on www.otpp.com or www.FundingYourPension.com

NEWS BRIEFS

Get ready for your close-up!

Retiring this year? Send us a photo from your first day of retirement. We'll use your submissions to create a photo essay celebrating this milestone. Check Pension News Online for updates.

Please send photos to: member_communications@otpp.com

Annual meeting draws big crowd

Roughly 500 members attended Teachers' annual meeting, with many more viewing from home via a live webcast. If you weren't able to make it, visit www.otpp.com's Annual Reporting section to view an archive of the webcast.

Teachers' to acquire insurance agency holding firm

Teachers', with Century Capital Partners, has a definitive agreement to purchase an 84% interest in BroadStreet Capital Partners. BroadStreet is an Ohio-based holding company that makes majority interest investments in high-performing independent insurance agencies. The company focuses on the middle-market retail insurance brokerage industry in both commercial and property and casualty insurance. It has annual revenue in excess of $100 million.

Teachers' Private Capital appoints head of London office

Jo Taylor has been appointed as the head of the London office of Teachers' Private Capital (TPC). Jo will serve as a Vice President of TPC and Teachers' senior representative for Europe, the Middle East and Africa. In this role, he will lead a growing team of professionals responsible for sourcing, negotiating and executing investments ranging between C$100 million and C$300 million. His private equity career includes more than 20 years with 3i Group Plc, where he held a number of progressively senior roles and was a member of the group management and investment committees.

Pensionwise™ is published for members of the Ontario Teachers' Pension Plan.

We appreciate your comments about anything you read in *Pensionwise*. Please e-mail: member_communications@otpp.com

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Printed on recycled stock
ISSN 1706-0214

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PM# 40062973